

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Speier Analyst: John Pavalasky Bill Number: SB 1067

Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: 6-17-03

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Water's-Edge Election/Inverted Corporations

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended April 24, 2003.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☐ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- ☐ FURTHER AMENDMENTS NECESSARY.
- ☐ DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 24, 2003, STILL APPLIES.
- ☒ OTHER - See comments below.

SUMMARY

This bill would treat a foreign incorporated entity that meets the definition of an "inverted domestic corporation" as a domestic corporation for purposes of a water's-edge election.

SUMMARY OF AMENDMENT

The June 17, 2003, amendments would no longer deny a water's-edge election to corporations that invert (move their headquarters out of the United States) but instead would include the income and apportionment factors from an affiliated "inverted domestic corporation" in the water's-edge combined reporting group for California tax purposes.

The June 17, 2003, amendments resolved the TECHNICAL CONSIDERATIONS, IMPLEMENTATION CONSIDERATIONS and ARGUMENTS/POLICY CONCERNS contained in the analysis of the bill as amended April 24, 2003. New discussions for EFFECTIVE/OPERATIVE DATE, THIS BILL, and REVENUE ESTIMATE are provided. The remainder of the previous analysis of the bill as amended April 24, 2003, still applies.

EFFECTIVE/OPERATIVE DATE

This bill would apply to corporations making a water's-edge election on or after January 1, 2003, and to corporations that currently have a water's-edge election in effect, but not until the expiration of the current term (seven years) of that water's-edge contract.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director

Date

Brian Putler

06/20/03

POSITION

Pending.

ANALYSIS

THIS BILL

This bill, once fully implemented, would eliminate the impact of corporate inversions for California tax for water's-edge electors. This would be done by treating a foreign incorporated entity that meets the definition of an "inverted domestic corporation" as a domestic corporation for purposes of a water's-edge election. That is, it would include the income and apportionment factors from an affiliated "inverted domestic corporation" in the water's-edge combined reporting group for California tax purposes.

An "inverted domestic corporation" is defined as a foreign incorporated entity that acquires the property of a domestic corporation or specified partnerships if:

1. Immediately after the acquisition:
 - More than 50% of the stock is held by former shareholders (or partners) of the domestic corporation (or partnership), or
 - More than 50% of the stock is held by domestic shareholders; and
2. It meets an asset test.

Under this test, the assets of the domestic corporation or partnership must be at least 80% of the assets of the resulting foreign incorporated entity. That test would ensure that foreign corporations with other substantial assets are not adversely affected.

This bill would also require the Franchise Tax Board to prescribe legislative regulations to treat warrants, options, contracts to acquire stock, convertible debt instruments, and other similar interests as stock and to treat certain stock as not being stock.

ECONOMIC IMPACT

Revenue Estimate

Projected revenue gains for this proposal will increase over time as shown in the table below:

Fiscal Year Cash Flow Impact Enactment Assumed After 6/30/03 \$ Millions						
	2003-4	2004-5	2005-6	2006-10	2010-13	Total
New	+1	+2	+3	+22	+27	+55
Existing	0	0	0	0	+44	+44
Total	+1	+2	+3	+22	+71	+99

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Revenue Discussion

A number of corporations that have already inverted have been identified. Analysis of their tax returns suggests that the revenue cost of these corporate inversions will be approximately \$132 million over the next 10 years. Because these corporations had current valid water's-edge contracts in effect on January 1, 2003, the first seven years of this revenue, \$88 million, would not be recaptured. The amendments would, however, generate \$44 million in revenues in years eight through 10, after the effects of water's-edge contracts in effect on January 1, 2003, expire.

Assuming that new corporate inversions occur at the same rate as during the last several years, and that the tax effects are approximately the same for old and new corporate inversions, the revenue raised by this bill will initially increase at a rate of about \$1 million per year. For the first seven years, this revenue from newly inverted corporations will be the only revenue from this bill. In 2010, when water's-edge contracts in effect on January 1, 2003, expire for companies that have already inverted, the increase in revenues from this bill will be the sum of the impact of old and new corporate inversions. Over 10 years, the total revenue raised by this bill is projected to be \$99 million (\$55 million from new corporate inversions + \$44 million from old corporate inversions).

LEGISLATIVE STAFF CONTACT

John Pavalasky
Franchise Tax Board
845-4335
john.pavalasky@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov